Profile of the Economy

[Source: Office of Macroeconomic Analysis]

Real gross domestic product (GDP)

In the first quarter of 2000, real GDP increased at a 5.4 percent annual rate. This was below the outsized 7.3 percent increase in the fourth quarter of 1999, but it exceeded the average quarterly gain of 4.4 percent during the last 4 years. The slowdown reflected deterioration in net exports as well as a fallback in inventory investment and in Federal spending. The latter two categories grew very rapidly in the fourth quarter of 1999 in anticipation of possible disruptions relating to the Year 2000 (Y2K) bug.

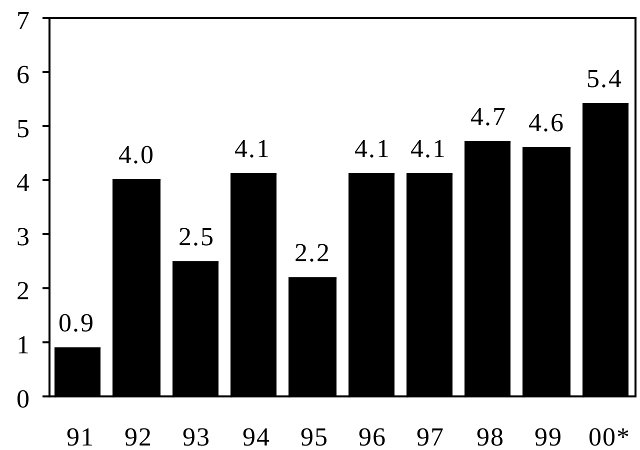
Although overall GDP growth slowed, domestic purchases other than inventory investment were extraordinarily strong in the first quarter of 2000. Domestic final demand accelerated to an 8.0 percent annual rate from 5.9 percent in the fourth quarter of 1999. Personal consumption expenditures surged at an 8.3 percent pace, the fastest quarterly rate since early 1983. Growth in consumer spending picked up markedly in the last 3 years, fueled by rising income and by the wealth effects of stock market gains. Business fixed investment also strengthened in the first quarter of 2000. It rebounded at a 21.2 percent pace after growing just 2.9 percent in the fourth quarter of 1999. Deferred purchases of computer equipment until after the Y2K date change partly contributed to the investment swing.

The growing foreign trade deficit continued to drag on the economy in the first quarter of 2000, subtracting 1.3 percentage points from real growth. This was more than in recent quarters but less than the drag in the first quarter of 1999.

The national accounts measures of inflation accelerated in the first quarter of 2000, mainly reflecting higher energy prices. The GDP price index moved up at a 2.7 percent annual rate compared with 2.0 percent in the fourth quarter of 1999. However, after excluding food and energy, the core rate increased just 2.1 percent. This was less than the 2.2 percent rate in the previous quarter.

Growth of Real GDP

(Percent change, fourth quarter to fourth quarter)



*Based on first quarter

Inflation

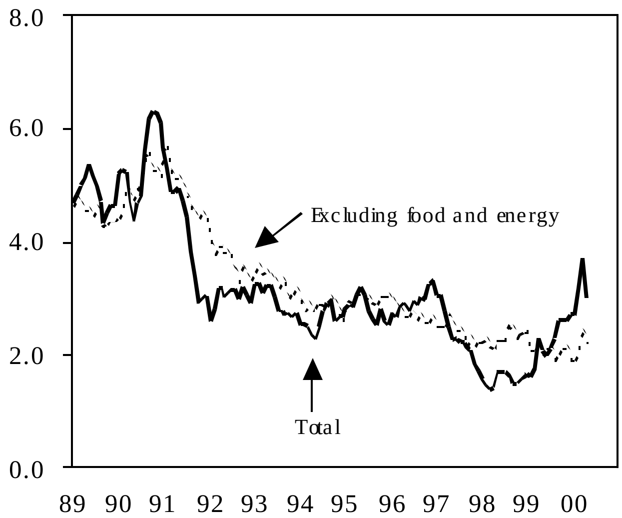
Inflation has picked up this year. Energy prices have increased sharply and are responsible for much of the acceleration. Core inflation, which excludes food and energy, still remains relatively moderate. Rising compensation costs are causing some concern, but continued productivity growth should help minimize the passthrough to prices.

Consumer prices increased at a 4.3 percent annual rate during the first 4 months of 2000. This was an acceleration of about 1-1/2 percentage points from 1999. Higher oil prices greatly contributed to the rise. Prices of petroleum-based energy products have risen at an annual rate of more than 50 percent after jumping by almost 30 percent in 1999. Core inflation accelerated to a 2.9 percent annual rate. That was up one percentage point from the 1.9-percent rise in 1999, the smallest yearly increase since 1965. Food prices rose at a modest 1.5 percent pace in 2000.

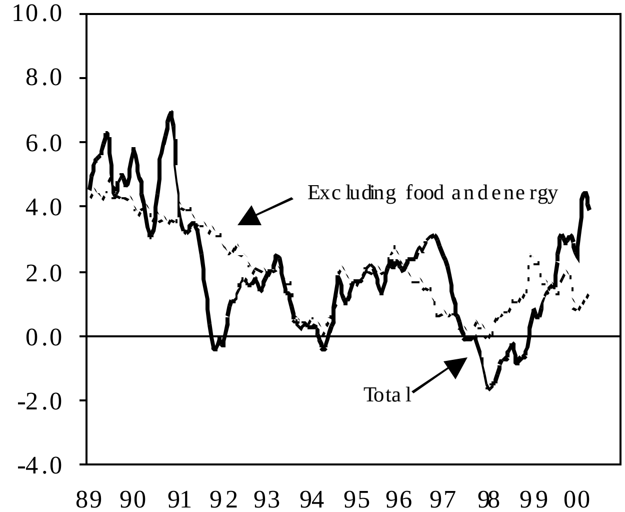
At the producer level, the pattern for finished goods prices generally mirrored developments at the consumer level. Finished goods prices rose at a 5.4 percent pace in the first 4 months of 2000, up from 2.9 percent in 1999. Core inflation remains moderate, increasing at a 1.2 percent annual rate. This follows a 0.9 percent rise in 1999. The increase in energy prices has accelerated from a little more than 18 percent in 1999 to just under 25 percent in 2000. Further back in the production chain, core prices for crude goods are rising at a slower rate than in 1999, but prices for core intermediate goods picked up.

Hourly compensation in the nonfarm business sector increased at a 4.2 percent annual rate in the first quarter, little different from the 4.3 percent rise recorded for all of 1999. Productivity growth slowed to a 2.4 percent annual rate during the first quarter of 2000 after a huge 6.9 percent jump in the fourth quarter of 1999. This boosted the increase last year to 3.7 percent. As a result, unit labor costs moved up at a 1.8 percent annual rate in the first quarter of 2000 after increasing by a slight 0.6 percent in 1999. The employment cost index for total compensation, a separate but closely watched compensation measure, jumped by 1.4 percent in the first quarter, an annual rate of 5.4 percent. Benefit costs rose sharply.

Consumer Prices
(Percent change from a year earlier)



Producer Prices - Finished Goods
(Percent change from a year earlier)



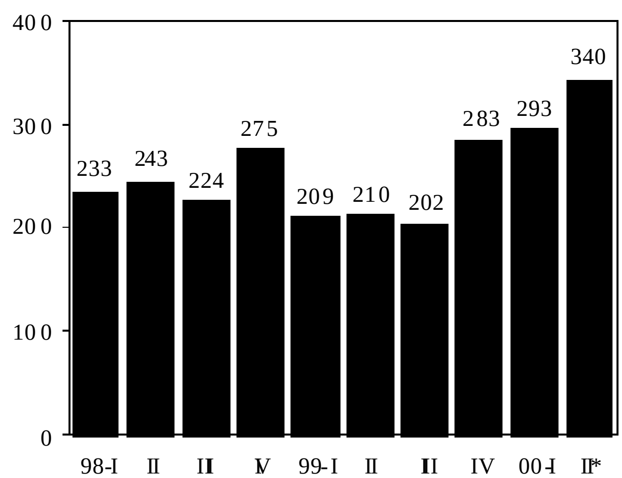
Employment and unemployment

Labor markets continue to grow at a brisk pace during the first 4 months of 2000. The unemployment rate fell below 4 per cent for the first time in 30 years, but so far there is only modest evidence that wage pressure might be developing.

In recent months, the temporary hiring of employees to conduct the 2000 decennial census distorted the reported total nonfarm payroll employment growth. Excluding temporary census workers from the total nonfarm job increases of 458,000 in March and 340,000 in April would have trimmed the totals to 341,000 and 267,000, respectively. These are still very strong results. So far in 2000, monthly job growth has averaged 243,000, after adjustment for census workers. This was slightly stronger than the 226,000 averaged during all of 1999. Job gains picked up in construction, which was helped by favorable weather early in 2000. Employment has been stable in manufacturing and increased in mining after declines for both in 1999. The large private service-producing sector had more temperate increases this year than last. Monthly gains averaged 185,000 during the first 4 months of 2000, down from 203,000 averaged during all of 1999. Nonetheless, this still represents the largest source of job growth.

Unemployment Rate
(Percent)

Establishment Employment
(Average monthly change in thousands)



*Based on April data.

The economy continues to operate at a very high rate of labor utilization. Unemployment declined from 4.1 percent of the labor force in February and March to 3.9 percent in April. This was the lowest rate since the same reading in January 1970. The share of the working-age population employed reached a record-breaking 64.9 percent in April.

Wage gains in nominal terms have remained surprisingly low. Over the past 12 months, average hourly earnings of production and other nonsupervisory workers advanced by only 3.8 percent. This represents a slowing from a 12-month increase of 4.4 percent 2 years ago, an unusual development in a period of tight labor markets. Growth during the first 4 months of 2000 picked up to a 4.5 percent annual rate. This trend could be the first hint of acceleration, although developments over such a short period are seldom conclusive. In real terms, earnings rose by about 1/2 percent during 1999, extending the prior 5 years' positive readings for the strongest performance since the early 1970s.

Real disposable personal income and consumer spending

Personal income rose at a 6.3 percent annual rate in nominal terms in the first quarter of 2000. This extends the 6 percent growth pace for the prior 4 years. Wages and salaries (the largest source of personal income) rose at a sharp 7.7 percent annual rate in the first quarter, up from 6.5 percent during all of 1999. Income from dividends and interest also strengthened somewhat relative to 1999. While nominal income growth remained reasonably stable, growth of real disposable (after-tax) personal income slowed in the first quarter to 3.2 percent at an annual rate from 3.7 percent in 1999. The slowdown reflected higher inflation in items purchased by consumers in the first quarter, mainly resulting from faster growth in oil prices.

Real consumer spending surged at an 8.3 percent annual rate in the first quarter of 2000, the largest quarterly increase since 1983. The biggest gains continued to center in areas of discretionary spending, such as motor vehicles, furniture and appliances, recreational services, and clothing. Information on retail sales in April suggests that spending flattened out some early in the second quarter of 2000 after the outsized gain of the first quarter.

The greater increase in spending than in disposable income pulled the personal saving rate down further to only 0.7 percent in the first quarter of 2000 from 1.8 percent in the fourth quarter of 1999. The latest reading is the lowest since negative saving was recorded in 1933. The saving rate has declined steadily from a recent high of 8.7 percent in 1992, primarily because of the growing "wealth effect" resulting from the stock market rise. Increases in asset values are not counted as income in the national income and product accounts, from which saving is calculated, but nonetheless contribute to the willingness of consumers to spend.

Industrial production and capacity utilization

Industrial production in manufacturing, mining and utilities continues to pick up in 2000. During the first 4 months of 2000, production rose at a strong 7.9 percent annual rate. This represents a sharp improvement from 4.7 percent over the 12 months of 1999 and only 2.5 percent during 1998, when the effects of the Asian crisis curtailed activity.

Manufacturing production, which accounts for 88 percent of total industrial output, has increased at an 8.3 percent annual rate so far in 2000 compared to a gain of 5.2 percent during all of 1999. The high-tech industries of computers, semi-conductors and communications equipment continue to buoy growth, with an annual rate gain approaching 60 percent this year. Excluding the high-tech category, factory output is advancing at only a 2.8 percent rate so far during 2000, but that is still stronger than the 1.6 percent rise during all of 1999. Production in the mining industry (5-1/2 percent of industrial output) has risen at a 3.7 percent pace in 2000, compared to 1.4 percent in 1999. Output in mining had plunged by 7.0 percent during 1998, when falling oil prices resulted in sharply reduced activity in oil and gas extraction.

The combination of substantial production gains and slower capacity building resulted in a higher rate of industrial capacity utilization in 2000. In April, the utilization rate reached 82.1 percent. This was slightly above the long-run average of 82.0 percent and the highest level since May 1998. Despite a 1.7 percentage point advance over 1999, this rate still remains 2.3 percentage points below its expansion high of 84.4 percent reached in January 1995.

Nonfarm productivity and unit labor costs

There has been growing recognition that U.S. productivity growth has moved to a higher trend rate in recent years, the result of innovations and investment in information technology. Nonfarm business productivity (real output per hour worked) has risen at a 2.8 percent annual rate since the end of 1995. That was double the rate averaged over the previous two decades. During 1999, nonfarm productivity grew by a particularly strong 3.6 percent, including gains at nearly a 6.0 percent pace during the final two quarters. In the first quarter of 2000, growth moderated to a still strong 2.4 percent annual rate.

Hourly compensation costs in the nonfarm business sector rose at a 4.2 percent annual rate in the first quarter of 2000, about the same as averaged in 1999. Unit labor costs, which reflect the interaction of compensation and productivity, increased at a 1.8 percent annual rate in the first quarter after rising by a narrow 0.6 percent during all of 1999. Recent very low growth rates in unit labor costs have been important in helping to contain inflation and hold growth of prices of U.S. output to only 1.8 percent over 1999.

Productivity in the manufacturing sector continues to register impressive gains. Factory output per hour soared at a 6.9 percent annual rate in the first quarter of 2000. This matched the strong rate of increase during all of 1999. Hourly compensation costs in manufacturing rose at a 3.8 percent pace in the first quarter. Because the increase in compensation was more than offset by rapid productivity growth, unit labor costs in manufacturing fell at a 2.9 percent pace in the first quarter. The drop extended a 6-year declining trend, reducing factory unit labor costs by a total of 8.7 percent.

Current account balance

The current account measures international trade in goods and services as well as the net flow of investment income and net unilateral transfers. The current account has been in deficit almost continuously since the early 1980s. In 1999, the current account deficit reached a record $338.9 billion, representing an all-time high 3.7 percent share of nominal GDP.

The deficit widened substantially during the 1990s primarily because of deterioration in the merchandise trade balance. U.S. economic growth outpaced that of its major trading partners, causing imports to grow much more rapidly than exports. Sharp dollar appreciation from 1995 to 1998 and higher prices for imported oil since 1999 contributed to the widening trade gap. The merchandise trade deficit doubled in the last 5 years to $347.1 billion in 1999, a record high. It continued to increase in the first quarter of 2000.

Other major components of the current account contributed to the growing deficit. The surplus on trade in services narrowed in the last 2 years. In addition, what had been a positive balance on investment income shifted to a negative in 1998 and 1999. Large inflows of capital into the United States boosted payments of earnings and interest to foreigners.

The current account deficit is matched by offsetting transactions in the financial and capital accounts, plus a statistical discrepancy. The financial account recorded a net inflow of $378.2 billion in 1999 as inflows for foreign-owned assets in the United States far exceeded outflows for U.S.-owned assets abroad. Net inflows of foreign direct investment and of private securities, including equities, jumped sharply.

Exchange rate of the dollar

Since 1995, the exchange rate of the dollar against a broad index of important U.S. trading partners' currencies increased markedly as economic growth in this country outpaced that of most of the U.S.'s trading partners. After some volatility in 1998, the exchange rate leveled out in 1999 before rising again since October. The dollar appreciated by 1.9 percent from October through April against the broad index of currencies.

All of the appreciation was against the major currencies of the most important U.S. trading partners. These currencies consist of the euro plus those of other major partners such as Canada, Japan and the United Kingdom. Since October 1999, the dollar has increased by 4.8 percent against that narrow range of major currencies. In contrast, the dollar remains relatively steady against the currencies of other important U.S. trading partners.

The performance of the dollar against the aggregate index of major currencies masks divergent patterns among individual currencies. The dollar appreciated steadily by more than 13 percent from October through April against the euro. The exchange rate against the yen was more volatile. Since its most recent peak in August 1998, the exchange rate of the dollar against the yen fell by almost 30 percent through December 1999, then improved by 3 percent from December through April. The yen strengthened in 1999 amid expectations that a recovery in the Japanese economy was imminent. In addition, strong foreign interest in Japanese equities helped augment the yen's rise.

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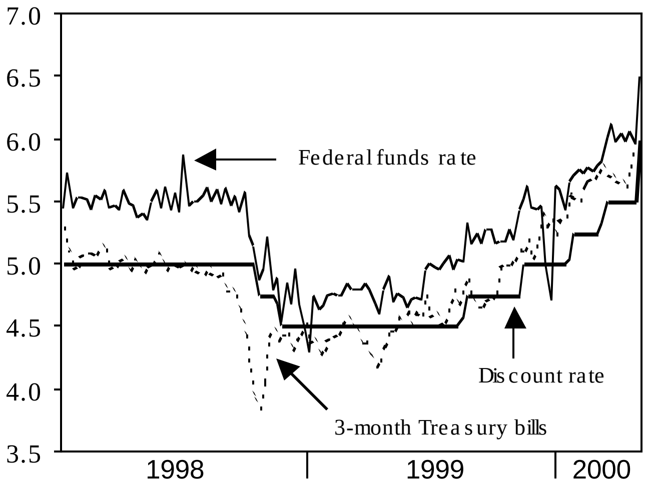
Interest rates

The Federal Reserve tightened monetary policy because of concern that the faster growth in demand than in potential supply could result in inflation. In 1999, the Federal Reserve raised short-term interest rates three times by a total of 75 basis points. This reversed the easing moves made in 1998 during the period of global financial turmoil. So far in 2000, the Federal Reserve increased rates three more times by a total of 100 basis points (1 percentage point). The six increases raised the key Federal funds target rate (the rate that banks charge each other for overnight loans) from 4.75 percent to 6.50 percent. The discount rate (the rate the Federal Reserve charges banks for short-term funds) was raised from 4.50 percent to 6.0 percent. The market interest rate for the 3-month Treasury bill, which usually centers on the level of the discount rate, was about 6.2 percent in mid-May.

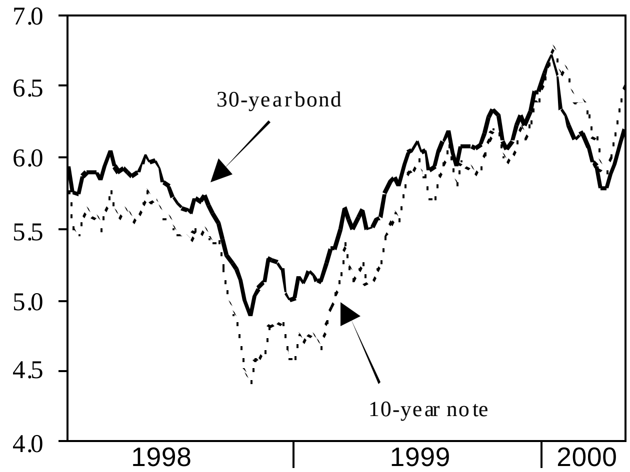
Rates on long-term Treasury securities increased through 1999 and in early 2000 as economic growth continued to expand at a rapid pace. The interest rate on the 10-year Treasury note rose from about 4.7 percent at the end of 1998 to over 6.6 percent in early 2000. The rate on the 30-year Treasury bond rose from 5.1 percent to 6.6 percent over that period. In 2000, long-term yields eased as the price of securities rose. The higher prices largely reflected concern that buybacks and reduced new long-term debt issuance by the Treasury because of growing budget surpluses would shrink the Treasury securities supply. In May, yields moved up again.

Mortgage interest rates, which follow the pattern of the interest rate on the 10-year Treasury note, also have increased since 1998. The interest rate on a conventional 30-year fixed rate loan rose from a 30-year low of 6.7 percent in October 1998 to 8.2 percent in April 2000. Rising mortgage interest rates have dampened housing activity.

Short-term Interest Rates
(Percent)



Long-term Interest Rates
(Percent)



Housing

Activity in the housing market has slowed a bit because of rising mortgage interest rates, but it remains at a fairly high level. Rapid gains in employment and income and the wealth effects of rising stock prices have continued to support strong demand for housing despite the increase in mortgage costs.

Sales of new single-family homes posted a new record of 904,000 in 1999. This was only about 2 percent higher than in 1998 when new home sales rose by almost 10 percent. Resales of existing homes also reached a new record in 1999, climbing 4.5 percent above the 1998 total to 5.2 million. New home sales accelerated in the first quarter of 2000, partly due to unseasonably mild weather.

Growth in sales of both new and existing homes over the past several years has led to a dramatic increase in homeownership. Since the beginning of 1993, the number of new home owners has grown by almost 9 million. The homeownership rate rose to 67.1 percent in the first quarter of 2000, an all-time record.

Construction of new housing units moved up to 1.67 million in 1999. This was the highest annual total since 1986. Starts of single-family homes rose by 5 percent to a 21-year peak, while starts of multi-family units declined slightly. Total housing starts rose further in the first quarter of 2000 to an annual rate of 1.73 million. All of that increase was for multi-family construction. Starts of new single-family homes eased slightly after a large jump in the fourth quarter of 1999. Strength in total housing starts in 1999 and 2000 translated into large increases in real residential investment.

Federal budget

The Federal budget is expected to show a much larger surplus in fiscal 2000 than the $167 billion projected in the Administration's "Fiscal Year 2001 Budget" (released in February). Fiscal 2000 will mark the third consecutive year of Federal budget surplus after 28 years of deficits. The surplus grew to $124 billion in fiscal 1999 from $69 billion in fiscal 1998. Strong economic growth and passage of deficit reduction programs placed the deficit on a downward course after it reached an all-time high of $290 billion in fiscal 1992. The surpluses are estimated to reduce the amount of Federal debt held by the public by a total of $355 billion by the end of fiscal 2000.

Since 1992, growth in Federal outlays has remained restrained while strong growth in jobs, income and capital gains has boosted receipts. Outlays increased just 3.0 percent in fiscal 1999 and dipped to 18.7 percent in relation to GDP, the lowest rate in 25 years. Outlays are expected to grow somewhat faster in fiscal 2000 than last year but by much less than receipts. Receipts were projected to rise by about 7.0 percent this year compared with 6.1 percent in fiscal 1999, but so far the pace has risen even higher. Improvement in corporate profits and strong increases in individual income and capital gains have driven the acceleration in tax receipts this fiscal year.

The "Fiscal Year 2001 Budget" forecasted that surpluses will continue. By directing the surpluses toward continued debt reduction, firming the long-run solvency of Social Security and Medicare, and making investments to enhance the economic expansion, the $3.6 trillion debt held by the public at the end of fiscal 1999 could be completely paid off by 2013.

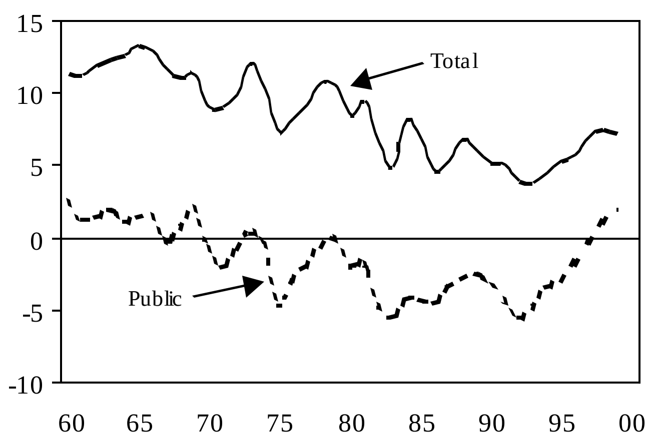
Net national saving and investment

Net national saving averaged 7.3 percent of net national product (NNP) in 1999, slightly below the 7.6 percent for all of 1998. (Net saving and NNP exclude depreciation to replace wornout or obsolete equipment, software and structures used in production.) The saving rate for 1999 is still nearly double the 3.9 percent reached in 1993, the lowest rate for any year since the 1930s.

The swing in the Federal budget from large deficits into surplus has more than accounted for the improvement. As a result, the public sector moved from dissaving equivalent to 4.7 percent of NNP in 1993 (and an even larger 5.4 percent in 1992) to saving of 2.1 percent in 1999. Despite the progress, net saving still remains well below the 11.6 percent of NNP averaged in the 1950s and 1960s.

Net National Saving

(Saving as a percent of NNP)



Private saving declined from a recent high of 9.4 percent of NNP in 1992 to 5.2 percent in 1999. A sharp fall in saving by households has more than offset a gain in corporate saving. Increased wealth generated by a surging stock market is an important factor in the reduced desire of households to save out of current income. In 1999, personal saving was equivalent to only 1.9 percent of NNP, down from 7.4 percent in 1992. Growth of corporate profits, on the other hand, lifted net corporate saving from 2.2 percent of NNP in 1992 to 3.3 percent in 1999.

Net domestic investment (by government and private industry in structures, equipment, software and inventory) increased from a very low 5.2 percent of NNP in 1991 to 9.7 percent in 1999. A large portion of this investment was financed from abroad, as U.S. net foreign investment swung from 0.3 percent of NNP in 1991 to -3.9 percent in 1999.